SUBMISSION OF THE PROVINCE OF NOVA SCOTIA TO THE MEETING OF FIRST MINISTERS CONCERNING THE FEDERAL GOVERNMENT'S TAX REFORM PROPOSALS

SEPTEMBER 14, 15 AND 16, 1970

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1. Since the Federal Government introduced its proposals for tax reform in November of 1969, much discussion has taken place. These discussions have taken place at federal and provincial meetings, in the press, on radio and television, and by submission of briefs to the Standing Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance, Trade and Economic Affairs. Nova Scotia has previously submitted a brief and participated in discussions on the White Paper Proposals concerning Taxation.

2. The Government of Nova Scotia is greatly impressed by the concern shown by the taxpayers both in Nova Scotia and across the country over the last ten months as to how the proposals for tax reform affect their livelihood and future, and wishes at this time to re-emphasize certain matters which are still of concern to it.

3. While maintaining that the Government of Canada must have sufficient fiscal resources to discharge its responsibilities, the Government of Nova Scotia is of the opinion that the economy of Canada is so closely related to that of the United States that it is highly inadvisable for Canada to introduce a tax system which will compare even less favourably with that of the United States. Ideally Canadian taxes should be less onerous than American taxes, and our tax system should be an encouragement to enterprise and initiative in this country.

The tax system should be designed to attract and keep those people whose talents must be relied upon to encourage the economic growth of Canada and the Province of Nova Scotia.

4. The Government of Nova Scotia further is of the opinion that a proper tax system should provide the necessary incentives to taxpayers to work, save and plan for the future. While the Government of Nova Scotia believes that there should be a tax on capital gains, it does not believe that this tax should be at the rate set for income.

5. From the information which has been presented by the Federal Government and from our own observations, Nova Scotia is obliged to say that the Federal proposals for tax reform clearly do not achieve one of the goals which they should achieve: The reforms do not provide for a distribution of revenues between the Federal and Provincial Governments which reflects the expenditure responsibilities of these respective governments.

6. The Tax Structure Committee has had studies completed recently that show that the provinces have relatively heavier expenditure burdens to carry than has the Federal Government. The Federal tax proposals do not improve the provinces' positions materially. The proposals clearly indicate that in the near future there will be much greater pressure to raise taxes at the provincial level than at the federal level.

7. Of primary concern is the projection of revenues resulting from the White Paper Proposals and the apparent erosion of Nova Scotia's proportion of the over-all tax revenue to be generated.

8. Our specific concern is that, as set forth in the White Paper Proposals, Nova Scotia would not share appreciably in the extra tax revenue to be derived from the proposed changes. In fact, the White Paper estimate was that the first year of the new system would result in a net tax revenue reduction for Nova Scotia of almost $900,000 before adjustment of equalization payments.

9. Having in mind the nature of most industries in the Atlantic Region, which are small incorporated companies, the proposed elimination of the low rate corporate tax base (lower rate of corporation tax on profits below $35,000) will present a serious cash flow problem for small incorporated businesses, irrespective of whether they are eligible to be treated as partnerships for tax purposes. In many cases in the past the low rate tax base has served only as a means of postponing tax in the shareholders' hands; the proposals would serve to make such payment an immediate requirement. Unfortunately, the White Paper has made no proposal to follow the recommendations of the Carter Commission to allow such companies accelerated capital cost allowance as a compensating factor. Indeed, even this form of relief may prove inadequate because it is most effective in capital-intensive industries.

10. We share the concern of other provinces that the inclusion of capital gains in the tax reform package, taxable at full income tax rates (except for gains on shares of widely-held Canadian corporations), has not been offset by a corresponding reduction of estate tax rates. While it is difficult to predict the exact effect of the capital gains

tax, it seems clear that the combined effect of the proposed estate tax and capital gains tax rates will not only be real deterrents to the accumulation of capital, which Canada will need badly in the 1970's, they will also inhibit the taking of risks by businessmen whose efforts and talents are badly needed to start new enterprises.

11. It seems clear that one of the more serious consequences of the proposal to allow a dividend credit for corporation taxes paid will be upward pressure on the price of Canadian equity shares and a corresponding effect on interest rates. At a time when provinces and their municipalities are having serious difficulty in borrowing in Canada even at record high interest levels, this situation should not be further complicated. On the contrary, it is imperative that measures be introduced to alleviate the situation.

12. Recognizing that additional interest on government debt financing must ultimately be reflected in additional taxes, we suggest that a simple alternative to remove the pressure from provincial and municipal bonds would be to exempt from taxation the interest on such bonds. Upper limits to such an exemption could be set to avoid abuses by those with high incomes if this were considered necessary.

13. It has been suggested by some that the proposed increases in personal exemptions are insufficient, and largely ineffective in many low income cases. If it is felt desirable to re-appraise these exemptions, and if a significant further across-the-board increase in exemptions is

not feasible because of the loss of tax revenue, we suggest that consideration be given to a more practical approach, having a direct effect on those in the lower income brackets: the institution of a system of tax credits for dependents coupled with a total exemption from tax for those with incomes below the poverty level. The Province of Quebec has already introduced the latter system at the levels of $2,000 for a single taxpayer and $4,000 for a married taxpayer; such levels should be regarded as bare minimums. A system of dependency credits, which would replace the present system of exemptions for dependent children, would make a dependency claim for a low-income taxpayer as valuable as for a taxpayer at a higher income level.

14. We seriously question both the desirability and the practical effectiveness of the proposed five-year accrual of capital gains on shares of widely-held Canadian corporations. It is to be hoped that the federal authorities have already seen the merit of withdrawing this provision before the enabling legislation is drafted.

15. We submit that greater consideration must be given to the fact of inflation in application of the tax on capital gains. As proposed, this tax can be imposed when no real gain has been made in the appreciation of an asset - although the value of an asset in dollars may appear to be greater, the actual value may well be less than the value of the asset had it been sold years before. The White Paper Proposals give only nominal consideration to the inflation problem in providing

for taxing real property transactions. If there is to be a true valuation of property, it should eliminate purely inflationary gains, otherwise there is a risk of confiscation of much needed capital.

16. In Nova Scotia, as in other parts of Canada, we have many people whose lives have been spent on the land or fishing. They have not been given the opportunity to earn much money despite a life of hard work. Many such Canadians must depend on being able to realize as much cash as possible from their assets in order to retire. We suggest that a review should be made of the White Paper Proposals to ensure that people in these circumstances, who must sell such assets in order to retire, are not faced with an excessive burden of taxation. Closely related to this matter is the proposed taxation of gains on residences. The Government of Nova Scotia strongly recommends that such gains be exempt from taxation.

17. It is earnestly recommended that a careful re-appraisal be made of the entire personal tax rate structure, including the largely ineffective proposed averaging formula. The combined federal-provincial rates as proposed reach a maximum of slightly over 50% at the $24,000 income level, which is likely to be a considerably greater weight of tax than those in this bracket will pay in the United States. We are not alone in our concern that the present proposals may result in an undesirable shift from saving to spending, and the placing of an unreasonably heavy tax burden on those taxpayers in the middle

management and middle income range. Canada has a short supply of enterpreneurs, and the combined tax package of estate, capital gains, gift and income taxes proposed by the Federal Government is likely to discourage enterpreneurship and encourage out-migration of managerial talent.

18. The Government of Nova Scotia is also greatly concerned with the White Paper Proposals on investor-owned public utilities. The change in the treatment given to shareholders of these companies will in the end result be a hardship upon all Nova Scotians. If the shareholders of these utilities are not given credit for taxes paid by the utility corporation, then there will be a reluctance to invest in them with the result that capital requirements of the utilities will have to be obtained elsewhere, most likely from the consumers. In Nova Scotia this will mean an increase in rates paid by consumers for the utility services.

19. In the final analysis the Government of Nova Scotia believes that a tax system should take from the taxpayer only the amount that is necessary to provide the services of government and that every encouragement should be given to the individual, the small business, and large business to expand and develop, resulting in a real growth in the economy and a better quality of life for all Canadians.